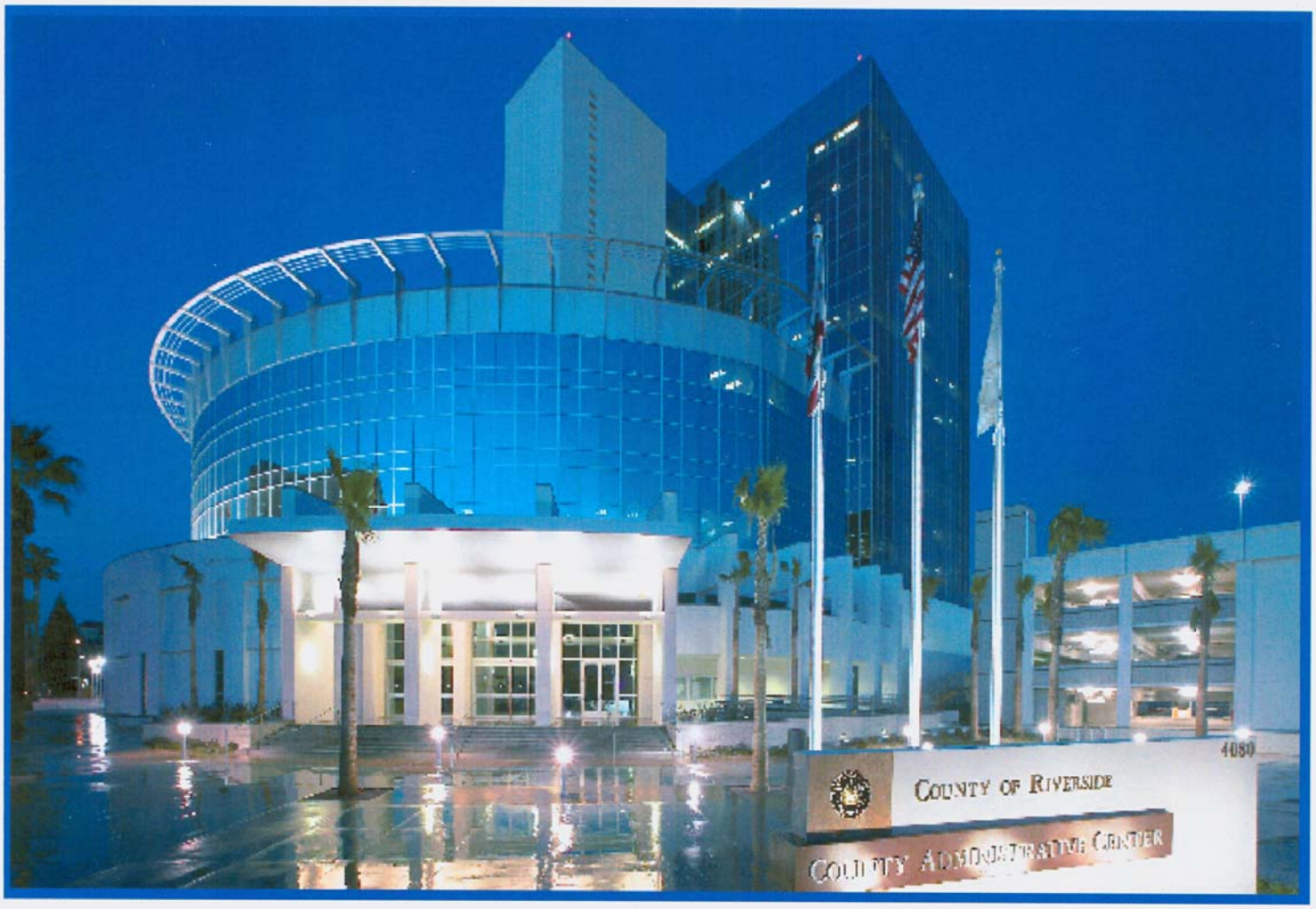
COUNTY OF RIVERSIDE
AUDITOR-CONTROLLER

OFFICE OF THE

AUDITOR-CONTROLLER

ROBERT E. BYRD, CGFM



EXTERNAL QUALITY ASSESSMENT OF ORANGE COUNTY'S INTERNAL AUDIT DEPARTMENT

OFFICE OF THE
COUNTY AUDITOR-CONTROLLER

County Administrative Center
4080 Lemon Street, 11th Floor
P.O. Box 1326
Riverside, CA 92502-1326
(951) 955-3800
Fax (951) 955-3802

COUNTY OF RIVERSIDE
AUDITOR-CONTROLLER

Robert E. Byrd, CGFM
AUDITOR-CONTROLLER

Bruce Kincaid, CPA
ASSISTANT
AUDITOR-CONTROLLER

August 27, 2007

Dr. Peter Hughes, CPA, Director of Internal Audit
Internal Audit Department
400 W. Civic Center Drive Room 232
Santa Ana, CA 92701-4521

Subject: Internal Auditor's Report 2008-001 – External Quality Assessment of Orange County's Internal Audit Department

Dear Dr. Hughes,

At your request, we conducted an external quality assessment (peer review) of the Orange County's Internal Audit (IA) Department as prescribed by the Institute of Internal Auditor's (IIA) Professional Practices Framework and as required by California Government Code, Section 1236. We conducted the peer review between July 30 and August 1, 2007, for internal audit operations of July 1, 2004 through June 30, 2007.

We utilized the IIA *Quality Assessment Manual, 5th edition* as well as the IIA's *Professional Practices Framework (January 2004 edition)* as primary criteria for performing the assessment. We conducted the assessment in accordance with auditing standards prescribed by the Institute of Internal Auditors.

Based on the information evaluated during the external quality assessment review, it is our opinion that the Orange County's IA activity *fully complies* with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*. This opinion means policies, procedures and practices are in place to implement the standards and requirements necessary for ensuring the independence, objectivity and proficiency of the IA function. Additionally, the IA activity conforms to the reporting standards issued by the Government Accountability Office (GAO). Nothing came to our attention that caused us to believe the IA activity did not comply with untested GAO standards.

We appreciate the courtesy and cooperation extended to us by the Deputy Internal Audit Director, internal audit staff, the Audit Oversight Committee, and county managers who participated in the peer review process. The feedback from the surveys and the interviews provided valuable information regarding the operations of the internal audit department and its relationship with management.

Michael G. Alexander, MBA, CIA
Chief Internal Auditor

Overview

The IIA's Standards and the GAO Government Auditing Standards require internal audit functions obtain external quality assessments to assess compliance with standards and to appraise the quality of their operations. U.S. *Government Auditing Standards* require these reviews at least every three years and the IIA requires them every five years. A periodic external quality assessment, or peer review, of the internal audit function is an essential part of a comprehensive quality assurance program.

The quality assessment for the Orange County Internal Audit Department was performed during the period July 30 to August 1, 2007 in accordance with the IIA Professional Practices Framework and as required by California Government Code, Section 1236. This process was requested by the Director of Internal Audit.

Objective, Scope and Methodology

The primary objective of the quality assessment was to evaluate the internal audit department's compliance with auditing standards during the period of July 1, 2004 through June 30, 2007. Additional objectives included identifying best practices and opportunities for suggesting improvements.

We used the following approaches to perform the quality assurance review:

1. Requested and reviewed responses to the IIA's *Tool 2 Quality Assessment and Tool 3 Chief Audit Executive Questionnaire*;

2. Reviewed key documentation related to the IA activity including:
    - IA charter and legal requirements;
    - County and IA organizational charts;
    - audit personnel position descriptions;
    - operating policies and procedures;
    - annual audit plan and management reports;
    - customer satisfaction surveys;
    - audit follow-up tracking documentation;
    - staff development and training documentation;
    - staff performance appraisals;
    - independence assertions; and
    - prior peer review reports.

3. Conducted interviews with key county officials and IA personnel, including:
    - members of the Board of Supervisors and Audit Oversight Committee;
    - the Auditor-Controller;
    - Deputy Director of Internal Audit;
    - selected members of County Executive Management;
    - the County's External Auditor; and
    - IA personnel.

4. Administered and summarized surveys to selected IA audit customers and to IA personnel; and

5. Reviewed seven FY2006-07 audit reports and supporting working papers covering the following audit projects:

    - Audit # 2428-A – Integrated Internal Control Review of the Auditor-Controller Accounts Receivable and Collection Process
    - Audit # 2428-B – Integrated Internal Control Review of the Auditor-Controller Accounts Receivable and Collection Process - IT Results
    - Audit #2511 - Audit of the Statement of Assets Held by the County Treasury as of December 31, 2005
    - Audit #2531 - Internal Control Review of Social Services Agency Contract Administration & Cash Disbursements Processes
    - Audit #2591 - Integrated Waste Management Department Contract Administration Process and Controls
    - Audit # 2595 - Performance Measure Validation of Child Support Services
    - Audit #2613 – District Attorney's Office Audit of Worker's Compensation Insurance Fraud Program

Results

Based on the information received and evaluated for the review period, it is our opinion the internal audit department *fully complies* with the IIA *Standards*. This opinion means policies, procedures and practices are in place to implement the standards and requirements necessary for ensuring the independence, objectivity and proficiency of the IA function. The IA activity is well managed, utilizes a systematic approach to improve the County's operations and employs highly qualified personnel. The IA activity is a first rate organization which demonstrates several best practices as noted below.

Our evaluation of the IA activity's conformance with GAO Government Auditing Standards (GAGAS) was limited to the reporting standards. We considered the reporting structure of an audit conducted in accordance with GAGAS for the purpose of providing an opinion on the IA activity's compliance with GAGAS. Our consideration of the reporting standards would not necessarily disclose non-conformance with the other standards. Based upon our limited review, we determined the IA conforms to GAGAS reporting standards. Nothing came to our attention to cause us to conclude that the IA activity did not comply with standards not specifically tested.

Although the internal audit charter is broad and allows the IA activity to serve the County in a manner consistent with the Standards to include performance of audits to evaluate the economy and efficiency of operations, the Board of Supervisors (Board) established a performance audit group and the Auditor-Controller decided to perform his mandated audit responsibilities. Additionally, discussions with members of the Audit Oversight Committee (AOC) disclosed a concern about the limited scope of audits performed by the IA activity. While we make no specific recommendations to change the internal audit practice, it appears a reasonable opportunity exists for the IA activity to add more value to the County by conducting audits that would otherwise be covered by other County auditors.

Through discussions with members of the AOC and IA management, we learned the IA has discontinued the Control Self Assessment (CSA) workshops. Accounting and auditing standards are placing greater emphasis on identifying risk and related internal controls. In light of this greater emphasis, local governments will have an added responsibility for identifying risk and reviewing related controls. Consequently, this may be an opportunity for IA to use the CSA tools and techniques to assist management in meeting this requirement.

Audit Oversight Committee Members and Management's Comments

Committee members and managers interviewed were complimentary of the professional proficiency, communication, and other skills of the internal audit staff. However, several committee members and managers interviewed felt there is a potential for the IA activity to add more value to the County by expanding the scope of audits. In addition, several mangers stressed their desire to be included in the annual audit planning/risk assessment process. We include these comments because we believe they will be useful to IA management and can potentially impact the effectiveness of IA activity and its ability to add value.

Best Practices

We observed several practices that demonstrate the internal audit activity's commitment to the highest level of quality and professionalism.

- Professional proficiency
  The IA staff individually and collectively possesses the knowledge, skills and other technical expertise required to sufficiently perform their duties. The IA is staffed with auditors which have college degrees and all possess a Certified Public Accountant designation. Additionally, 75 percent of the staff possesses additional professional designations, including Certified Internal Auditor (CIA), Certified Fraud Specialist (CFS), Certified Information Systems Auditor (CISA) and Certified Information Technical Professional (CITP). The IA activity permits each auditor to obtain 60 hours of Continuing Professional Education (CPE) annually. Auditors are provided approximately $3,800 per year for training as well as hours for study and preparation for examinations.

- Internal Audit Manual
  The IA activity has developed a comprehensive internal audit manual that consists of the following sections: County Operating Policies, Overview of the Internal Auditing Department, Audit Procedures & Tools, and Staff Qualifications & Development. The audit manual was last updated in June 2007, includes all relevant policies and procedures to guide the internal audit activity and can be used as an industry benchmark.

- Communication with the Audit Oversight Committee (AOC)
  The Director of the IA meets quarterly with the AOC to discuss significant matters such as IA activity scope and resources, implementation of major recommendations, recent audit reports and any other concerns or potential audit services. The AOC is responsible for presenting a summary of Committee activities and significant audit results to the Board through the distribution of the quarterly meeting material distribution packages. The quarterly meeting material distribution packages include meeting minutes along with supporting documentation for all items included on the agenda such as the IA status report, executive summary of external audit activity and the schedule of audit coverage. The open and continuous communication with the AOC enhances the IA's credibility and independence.

- Audit follow-up
  The AOC expects follow-up to be completed and recommendations to be implemented within one year. As such, the IA has developed and implemented a rigorous audit follow-up process. Upon issuance of an audit report, a Follow-up Action Report form is attached for the audited department to use for reporting when the audit

recommendations are implemented. IA follows-up to verify the implementation within six months initially, and if necessary conducts a second follow-up audit within one year. The follow-up process ensures the timely and effective implementation of audit recommendations in addition to ensuring management's responsibility and accountability.

- Internal Assessment
  As part of the quality assurance process, the IA activity prepared a comprehensive self assessment. The self assessment addressed all attribute and performance standards in an organized and concise manner and fairly reported the conclusions reached. Relevant documentation was included to support the opinions reached during the internal assessment. The self assessment was prepared by a qualified senior staff member and was reviewed by upper management.